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C O N F I D E N T I A L SECTION 01 OF 05 SOFIA 001652

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SUBJECT: BULGARIAN BANKS GENERALLY HEALTHY, BUT A FEW BAD
APPLES REMAIN

REF: A) SOFIA INCSR REPORT (E-MAIL
RADIVILOVA-GWILLIAMS ON NOV 3)

Classified By: Amb. John Beyrle for reasons 1.4 (b) and (d)

1. (SBU) SUMMARY: The Bulgarian banking sector is in its strongest position since the banking crisis of 1996. Thanks to stricter legislation, sound bank oversight and management, and an influx of large, stable foreign banks, most Bulgarian banks are prospering legitimately. Two skunks are circling the picnic, however. One is the high current-account deficit (septel to follow), and the other is money laundering. Among the 32 registered banks, there are around seven to eight banks whose practices are repeatedly cited as questionable or shady) funneling money for known criminals in money laundering schemes and involved in connected lending. The Central Bank and government authorities are aware of these banks, and claim to be trying to clean them up. Some good news in all of this is the growing investigative capability of the Financial Intelligence Agency (FIA); we need to continue visible support for its efforts, and those of its sister agencies (see para. 10). END SUMMARY

WHERE THE SECTOR NOW STANDS

2. (U) Following the financial crisis of 1996, when many banks went bankrupt, there remain fewer banks (32), but with sounder management. Bulgarian commercial banks' total assets are \$26.2 billion, or 80 percent of the country's GDP. Bank expansion is due to a developing private sector, growing credit demand and competitive pressures. Consolidation is expected as competition increases, exemplified in 2005 by the Italian UniCredit (Bulbank) acquisition of the Austrian HVB (Biochim and Hebros Banks) thus creating the country's largest financial group with almost 25 percent market share.

3. (U) The commercial banking sector is now mostly privatized. The largest, safest and cleanest are the foreign-owned banks) primarily from Austria, Italy, and Greece. The new international owners introduced good banking practices and improved the quality of banking services. The three largest banks in Bulgaria are DSK Bank, owned by OTP Bank of Hungary; Bulbank, owned by Unicredito Italiano; and the United Bulgarian Bank (UBB) owned by the National Bank of Greece. Citibank is the only U.S. bank, focusing on corporate, rather than retail clients.

PROBLEM AREAS: MONEY LAUNDERING AND CONNECTED-LENDING

4. (SBU) The major problems in the Bulgarian banking system include money laundering by Bulgarian and foreign criminals and connected lending. A previous concern, non-transparent ownership, has been largely addressed through legislation limiting the numerous offshore companies registered as bank shareholders and consolidating the banks' ownership structure. Connected lending continues to be a problem among some banks as their owners funnel money to related - less competitive - companies, with no intention of repaying. This leaves legitimate investors and account-holders holding the bag when bad loans go uncollected.

5. (U) Banking and financial authorities are aware of the most notorious banks and claim to be working hard to draft legislation and regulations to bring practices in line with Western norms, and to step up enforcement activities. Pursuant to the law, the Bulgarian National Bank's Supervisory Board conducts regular inspections of commercial banks' portfolios to keep track of the level of new lending and provisions against bad loans. However, a number of domestic banks apparently manage to escape strict scrutiny.

6. (C) The banks under observation are:

--First Investment Bank (FIB) was founded in 1993 by Tseko Minev and Ivailo Mutafchiev with funds of questionable origin. They remain owners, along with two offshore

companies from the Cayman Islands and the Channel Islands. The European Bank for Reconstruction and Development (EBRD), an early supporter and investor, recently told us that their participation in FIB is seen as bad spot on EBRD's record. FIB is now considered to have one foot in the legitimate retail world) it is known as one of the most aggressive and "polished" banks) as well as one in the murkier criminal realm.

In 2003, Minev and Mutafovich bought the Skopje-based Balkan Bank, a.k.a. "the Multigroup bank." Reportedly, the acquisition saved the Macedonian bank from liquidation and further inspection by the Central Bank authorities. FIB has allegedly extended approximately USD 133 million to shady energy consultant Hristo Kovachki's Atomremontstroy for its energy projects, as well as to help Kovachki acquire a majority stake in the Sofia Municipal Bank. Minev is reported to own most of Bansko ski resort. (Septel on questionable energy players and practices to follow.)

XXXXXXXXXXXX told us recently that in the past two years the FIA has conducted three or four on-site inspections of FIB that resulted in violations. XXXXXXXXXXXX stated that the bank reported suspicious transactions requiring closer examinations. However, when the FIA began conducting the investigations, FIB refused to provide additional information on the account and account holders. Therefore, FIA had no choice but to fine the bank as a result of noncompliance with banking compliance and secrecy laws. XXXXXXXXXXXX stated that both Bulgarian citizens and foreign managers ran FIB and that they had suspicious offshore holdings and accounts. XXXXXXXXXXXX was a little surprised that despite FIB's reputation, the EBRD was still interested in joint projects with it. He stated that despite the presence of foreign managers and the appearance of foreign investment, most of the money in the bank was private Bulgarian-held capital.

--Corporate Commercial Bank. This bank is also known as "The Bank of Risk Engineering," the most important) and notorious - player in the energy field, participating in almost all energy consultancy projects. For its close ties with Risk Engineering, owned by Bogomil Manchev, the bank is expected to be strongly positioned in the financing of the Belene project. The state-owned National Electric Company, which conducts non-transparent electricity sales through middle-men such as Manchev and Kovachki, deposits its funds there. The main shareholder of the this bank is Bromak Ltd., owned by Tsvetan Vassilev, which in 2004 was involved in a controversial privatization deal when it purchased the Sofia state railway plant for far lower than market value.

--International Asset Bank (former First East International Bank). "The bank of SIC" - formerly one of the most influential organized crime groups in Bulgaria. Recent reports describe Gazprom's interest in using IAB for its future projects in Bulgaria. The bank is owned by the Margini brothers, who are being held in one of Bulgaria's highest-profile cases against organized crime. Former State Security officers are suspected of involvement with the Marginis, who are reportedly close to both the Socialists and right-wing politicians close to former PM Ivan Kostov.

--Economic and Investment Bank (former Bulgarian-Russian Investment Bank). Offshore companies once owned this bank. Tsvetelina Borislavova, common-law wife of Sofia mayor Boiko Borissov, and Svetoslav Bozhilov own it now, together with Icelandic investor Thor Bjorgolfsson through his company Novator Finance Bulgaria. The concern with this bank is that it is practicing connected lending with lower quality companies that wouldn't otherwise qualify. There are also concerns about the origin of some of the assets Borissov allegedly passes through the bank.

--DZI Bank. Under its previous name, RosEximbank, this was "the Multigroup bank" of Emil Kyulev, who was killed in October 2005 by still unknown gunmen. The bank, the eleventh largest in Bulgaria, was bought in September 2006 by Greek Eurobank EFG. A police official before 1989, Kyulev allegedly entered the banking sector through the failed RosEximbank, owned in part by Michael Chorny, a Russian-Israeli businessman/organized crime figure who was expelled from Bulgaria in 2000 on the grounds of threatening national security. Many observers have said that at the time of his murder, Kyulev was trying to transform DZI into a legitimate organization.

XXXXXXXXXXXX told us that in the past DZI Bank was one of the biggest problems XXXXXXXXXXXX. DZI Bank had a bad track record of non-reporting and had several incidents of money-laundering activities. In August 2005, the bank was fined 20,000 BGN (USD 13,330) as a result of violating money-laundering laws. Since Emil Kyulev was killed, however, the bank has shown marked improvements in its reporting and compliance checks. Although the bank was again fined in August 2006 for failure to report suspected money-laundering activities, in XXXXXXXXXXXX opinion, it has demonstrated a clear change in "political will" in reforming. XXXXXXXXXXXX noted the exemplary reporting provided by DZI regarding several transactions by the Director of the State Hospital, a high ranking BSP official, who is a close friend of the Minister of Health Gaidarski, in November 2006. XXXXXXXXXXXX said he was surprised that the Bank would report this individual due to the political connections, but said he was pleased with the result. In discussing purported ties

between DZI and very-high ranking Government officials, XXXXXXXXXXXX said XXXXXXXXXXXX was never instructed or pressured to stop XXXXXXXXXXXX investigations of DZI - something XXXXXXXXXXXX cannot say was true for all of the banks. (Unfortunately, XXXXXXXXXXXX did not elaborate.) XXXXXXXXXXXX admitted that he would be extremely naive to think that DZI has completely reformed all of its ways, but stated that DZI was one good example of how vigilance, analysis, and compliance coupled with a desire to reform could bring a bank into line in a short period of time.

--Investbank (former Neftinvestbank and International Orthodox Bank) "The Bank of Bishops and Generals"). Investbank is associated with Russian/Lithuanian/Monaco businessman Denis Ershov and Bulgarian Mitko Sabev. Ershov was expelled from the country about the same time Michael Chorny was, and the two are suspected of joint criminal activity. Sabev is now Chair of the Supervisory Board of Petrol AD company, a major oil distributor company partially owned by Russia's Lukoil. Petya Slavova, previously married to Sabev, who has strong interests in tourism, controls Investbank. Her company, Festa Holding, owns first-class hotels in Sofia and on the Black Sea, and sells luxury wine and other alcohol. Slavova is believed to be the richest woman in Bulgaria. Although Slavova is currently seen to be succeeding on her own merits, Ershov and Sabev allegedly were the major sources of her financial stability and growth over the years.

--Central Cooperative Bank, a.k.a., "The bank of TIM." TIM was started in Varna as a grain trading group, but has interests in many sectors in Bulgaria) including media, retail and insurance - as well as being suspected of running organized crime operations. The group is close to taking over the state-owned Bulgarian River Transport and the air carrier "Bulgaria Air" through its ownership of the other national carrier "Hemus Air". Nikola Damyanov is Chairman of the Supervisory Board.

--The Sofia Municipal bank. The bank is now owned by the Sofia municipality and the businessman Hristo Kovachki, who wants to buy a majority share in the bank. In addition to his energy involvement, Kovachki is suspected of being part of the circle of companies close to the leader of Movement for Rights and Freedom (MRF) Ahmed Dogan.

(For further details on many of the above-mentioned individuals, companies and alleged Organized Crime syndicates, please review the "Bulgaria Organized Crime Report" available at <http://www.state.sgov.gov/p/eur/sofia/index.cfm>)

GOVERNMENT ACTION

17. (C) The Financial Intelligence Agency conducts random spot checks and hands out fines - 12 in the January-October 2006 time period. The FIA claims the Central Bank is not as vigilant, while the Central bank questions FIA's legal and structural capacity to fully investigate banks. In 2006, the amendment to the Law on Credit Institutions eased the investigation and prosecution of financial crimes by giving the Prosecutor General the right to request information without a court order in cases involving money laundering and organized crime. The banking sector is the only one to have substantially complied with the law's requirement.

18. (U) Banks and the 29 other reporting entities under the Law on Measures against Money Laundering (LMML) are required to apply "know your customer" (KYC) standards. Since 2003, all reporting entities are required to ask for the source of funds in any transaction greater than 30,000 Bulgarian Leva (BGL) (app. USD 19,000) or foreign exchange transactions greater than 10,000 BGL (app. USD 6,500), and to notify the Financial Intelligence Agency (FIA) of any cash payment greater than 30,000 BGL (app. USD 19,000).

19. (U) The 2006 LMML amendment expanded the definition of money laundering and the list of reporting entities; allowed FIA to obtain bank records without a court order; outlawed anonymous bank accounts; expanded the definition of "currency;" and required the disclosure of sources of currency exported from the country. Overall, experts view this legislation as comprehensive and in line with international standards. (See Ref A for more on money laundering law and practices.)

COMMENT/RECOMMENDATIONS

10. (C) The USG should increase cooperation with Bulgarian banking authorities, including visits by high-level Treasury officials to help the GoB better coordinate the activities of its turf-fighting agencies. The Central Bank, Financial Intelligence Agency and Financial Supervisory Commission are working together better than before, but need to continue their cooperation and better involve the Ministry of Interior and the Prosecutor's office. In addition, Bulgaria must look at the non-bank financial sector - particularly leasing - and work against potential money laundering there. As SEED funding phases out for Bulgaria, we need to find other sources for the relatively modest levels of money needed for the training and equipment that can help the FIA and its allies stay ahead of their well-funded adversaries. END
COMMENT/RECOMMENDATION

BANK OWNERSHIP AND BOOK VALUE

11. (U) Note: The Book Value is estimated as Shareholder Equity) "assets minus liabilities." Book value is more accurate for banks here than market value as very few of the domestic banks are currently traded on the stock exchange. Data as of June 30, 2006, Rate BGN/USD 1.48

--DSK Bank: OTP Bank RT, Budapest with 100 percent; Book Value: app. USD 403 million.

--Bulbank AD: UniCredito Italiano S. A. with 85.19 percent; Book Value: app. USD 380 million.

--United Bulgarian Bank: National Bank of Greece with 99.9 percent; Book Value: app. USD 318 million.

--Postbank: EFG Eurobank Ergasias S. A. with 75.33 percent; CEN Balkan Holdings Limited with 24.33 percent; Book Value: app. USD 191 million.

--Commercial Bank Biochim was sold in July 2002 to Bank Austria, Book Value: app. USD 150 million.

--Raiffeisenbank AD: Raiffeisen International Bank-Holding AG with 100 percent; Book Value: app. USD 145 million.

--Societe Generale Expressbank: Societe Generale, Paris with 97.95 percent; Book Value: app. USD 115 million.

--Economic and Investment Bank: Valhamar Group Ltd, a holding company from the group controlled by Thor Bjorgolfsson, through the subsidiary "Novator Finance Bulgaria Sarl" seated in Luxembourg with 34 percent; Tsvetelina Borislavova Karagiozova with 25.48 percent directly, and together with related parties Katex AD and Runo Kazanlak AD with 37.47 percent; Katex AD with 10.61 percent directly, and together with related parties Runo Kazanlak AD and Tsvetelina Borislavova Karagiozova with 37.47 percent; Svetoslav Bozhkov Bozhilov with 25.77 percent; Book Value: app. USD 104 million.

--First Investment Bank: Ivailo Dimitrov Moutafchiev with 31.83 percent; Tseko Todorov Minev with 31.83 percent; First Financial Brokerage House with 13.89 percent; FIB's web site attributes the remaining stake to: Growth Management Limited - 10.00 percent; Hillside Apex Fund Limited - 10.00 percent; Legnano Enterprises - 2.45 percent Hillside Apex Fund Limited and Growth Management Limited, two offshore companies, each acquired a 10 per cent stake in the bank from the European Bank for Reconstruction and Development, which has made a full exit from FIB. Book Value: app. USD 96 million.

--Hebrosbank was sold in March 2000 to Regent Pacific Group; Book Value: USD 76 million.

--Bulgarian-American Credit Bank: Bulgarian-American Enterprise Fund with 69.38 percent; Book value: app. USD 63 million.

--Central Cooperative Bank: CCB Group Assets Management EAD with 67.70 percent; Book Value: app. USD 55 million.

--Piraeus bank: Piraeus Bank, Athens, Greece with 99.79 percent; Bank Piraeus has recently acquired local Eurobank. Book Value: app. USD 52 million.

--MKB Union Bank: MKB Bank, Hungary with 60 percent; Union Group with 19.86 percent; Boras with 14.14 percent; Book Value: app. USD 43 million.

--DZI Bank: Greek Eurobank EFG bank with 74.26 percent (Note: data end-September). Eurobank EFG bank also majority owner of Bulgarian Post bank. Book Value: app. USD 39 million.

--Corporate Commercial Bank: Bromak with 89.21 percent directly and jointly with Victoria Insurance Company (indirectly) with 94.35 percent; Book value: app. USD 36 million.

--Allianz Bulgaria: Allianz Bulgaria Holding Ltd. with 79.72 percent; Allianz Bulgaria Holding Ltd is owned by the German Insurance Group Allianz AG, Munich. Book Value: app. USD 34.5 million.

--BNP-Paris Bank: Bank Nationale de Paris, France with 100 percent; Former Energy Minister Milko Kovachev is a member of the Supervisory Board. Book Value: app. USD 33.5 million.

--ProCredit Bank AD: ProCredit Holding AG with 59.13 percent; European Bank for Reconstruction and Development with 19.71 percent; Commerzbank AG with 19.71 percent; Book Value: app. USD 32 million.

-- Sofia Municipal Bank: Sofia Municipality with 67 percent; Kovachki has a minority interest. Book Value: app. USD 28.5 million.

--Encouragement Bank (Nasarchitelna Banka): Ministry of Finance with 99.995 percent; Book Value: app. USD 26 million.

--International Asset Bank: Dynatrade International with

25.51 percent; Book Value: app. USD 24.5 million.

--Tokuda Bank: International Hospital Services Co. with 93.84 percent; Book Value: app. USD 21 million.

--ING Bank: Book Value: app. USD 19.5 million.

--T.C. Ziraat Bank: T.C. Ziraat Bank, Ankara, with 100 percent; Book Value: app. USD 17.7 million.

--Investbank AD: Festa Holding with 78.73 percent; Vincom with 15.49 percent; Book Value: app. USD 15 million.

--Emporiki Bank Bulgaria AD: Commercial Bank of Greece, Athens with 100 percent; Book Value: USD 14.5 million.

--D Commerce Bank: Fuat Guven) a Turkish businessman, who is also the owner of the duty-free gas stations, is now a 100 percent shareholder. He bought the stake from two physical persons, also of Turkish origin, in September 2006. Book value: app. USD 13 million.

--NLB West-East Bank: Nova Ljubljanska Banka, Slovenia, with 72.51 percent; LB Maxima, Ljubljana, with 24.50 percent; Book Value: app. USD 12 million.

--Texim Private Entrepreneurial Bank: Paton Anstalt with 27.33 percent; Marieta Georgieva Naidenova with 15.24 percent; Pavlina Georgieva Naidenova with 15.09 percent; Book Value: app. USD 9.3 million.

--Alpha Bank: Branch of Alpha Bank AE, Athens, Greece; Book Value: app. USD 5.2 million.

--Citibank N. A.: Branch of Citibank N. A., New York, USA; Book value: app. USD 4.5 million.

--National Bank of Greece: A branch of the National Bank of Greece, Athens; Book Value: app. USD 1.3 million.
BEYRLE